

# Exhibit Y

## Reorg Research

Thu 06/08/2017 06:29 AM

### Puerto Rico

#### Budget Includes Significant Funding for Unspecified 'Other Operational Costs'

Gov. Ricardo Rosselló's [fiscal 2018 budget proposal](#) includes hundreds of millions of dollars in agency-level earmarks for unspecified "other operational costs" that could be used to pay down legacy debts, Office of Management and Budget Director José Iván Marrero said Wednesday as legislative hearings on the spending package got under way at the Capitol.

Marrero told Reorg Research after the eight-hour hearing that the earmarks count as expenditures rather than reserves and that earmarks could be used to amortize bills left pending from previous budgets.

"We're pursuing a public policy that ends the practice of carrying debts over between budgets," the OMB chief said. Marrero added that it would not be accurate to characterize the earmarks as reserves on top of a \$190 million liquidity reserve required by the PROMESA oversight board and included in the governor's proposed \$9.56 billion general fund budget for the fiscal year that starts July 1.

Marrero said the allotments are not related to what some bondholders have criticized as a 10-year, \$6.2 billion [reconciliation adjustment](#) implied in the certified fiscal plan that would serve as a cushion for cost overruns. "No, they are expenditures," Marrero said.

House Minority Leader Rafael "Tatito" Hernández circulated a list of such earmarks totaling \$525 million at 13 agencies that he referred to as "fiscal plan reconciliation adjustments." The earmarks cited range from a low of \$3 million at the Fire Department to highs of \$75 million at the Education Department, \$90 million at the Treasury Department and \$100 million at the Health Department.

Hernández, who chaired the House Treasury Committee during the previous governing term, questioned members of the administration's fiscal team as to whether the earmarks could be tapped if U.S. District Judge Laura Taylor Swain were to order the commonwealth debtors to make debt service payments above the level contemplated in the proposed budget and/or certified fiscal plan as part of the debtors' ongoing Title III proceedings.

Mohammad Yassin, general counsel at the Fiscal Agency and Financial Advisory Authority, answered that section 305 of PROMESA would block the judge from making such a move. "The judge doesn't have that authority," Yassin said.

Marrero told lawmakers in the joint hearing by the House Treasury Committee and Senate Treasury Committee that it is difficult to pinpoint how the earmarks may be spent, given the lag in audited financial statements, adding that they were based on historic budget woes at given agencies.

Puerto Rico government fiscal officials pointed to a lack of sound, updated financial data as a chief challenge in drafting Rosselló's fiscal 2018 budget proposal.

"One of the biggest challenges was the lag in audited financials. We didn't have reliable sources of information on government spending to draw on," Marrero testified, noting that the most recent comprehensive annual financial report dates back to fiscal 2014. Administration officials are working to get the fiscal 2015 and fiscal 2016 CAFRs out by this fall.

Marrero also pointed to a disjointed government accounting system as a hurdle to budgeting and financial disclosure processes, citing as an example the accounting system at the sprawling Education Department that cannot "communicate" directly with the Treasury Department.

Fiscal Agency and Financial Advisory Authority Executive Director Gerardo Portela signaled that

efforts under way to shore up information technology infrastructure would improve financial reporting that is key to complying with PROMESA and the certified fiscal plan, as well as regaining credibility on the capital markets.

Portela noted that a “blueprint” for improved financial reporting will be in place by August, when the Puerto Rico government, in conjunction with the PROMESA board, is tasked with developing a [work itinerary](#) for the governor to present and certify to the PROMESA board a range of monthly and quarterly reports as stipulated in Joint Resolution 187, one of four budget bills filed by the governor. Those reports are in addition to those that the governor must present to the board under Section 203 of PROMESA.

Marrero told lawmakers that the fiscal 2018 budget proposal was atypical because, among other reasons, the revenue estimates underpinning it were provided by the PROMESA oversight board. “Typically we would wait for revenue estimates from the Treasury Department. This time they ran through the PROMESA oversight board,” he said, pointing to section 202(b) of the federal statute.

House Treasury Committee Chairman Antonio Soto stressed that the revenue estimates were set by the PROMESA board, and he questioned the fiscal officials on that process.

Treasury Secretary Raúl Maldonado said the revenue projections were hammered out in daily meetings with PROMESA board consultants that entailed “line-by-line” analysis of existing taxes, new revenue measures and non-legislative measures including those based on input from the U.S. Treasury Department.

Marrero said in prepared testimony – which was also signed by the heads of AAFAF, Treasury and the Government Development Bank – that net revenue to the general fund “has particular importance.”

The estimate of \$9.172 billion in net revenue to the general fund in fiscal 2018 is \$84 million less than the \$9.256 billion target for the current fiscal year that ends June 30. The projected total for fiscal 2018 includes \$924 million from “additional income measures,” so projections tied to current taxes reach \$8.248 billion.

The revenue projections include significant declines in sales-and-use tax collections (down to \$1.567 billion in fiscal 2018 from \$1.701 billion this year) and the Law 154 excise tax on offshore manufacturers (down to \$1.533 billion from \$2.052 billion). The other revenue targets are lower across the board, including the corporate income tax, individual income tax, non-resident withholdings and taxes on alcoholic beverages, cigarettes, automobiles, rum shipments and “others.”

Maldonado and Marrero both said the revenue targets were set using the most conservative macroeconomic projections. The Planning Board had been scheduled to testify during the opening hearing on Wednesday but did not, and it was not clear that its testimony would be rescheduled.

Faced with anticipated revenue declines, the Treasury Department is ramping up compliance efforts, according to Maldonado, who said that 200 to 300 commonwealth employees would be transferred in under the new “single employer” law to work on tax collection efforts. The Treasury chief told Reorg Research that the agency has weighed a range of tax reform scenarios that are being presented to the governor with an eye toward the filing of legislation within two weeks.

The general fund budget proposal of \$9.562 billion is \$575 million more than current fiscal 2017 budget and is \$390 million more than the \$9.172 billion in projected tax revenue for the coming fiscal year. That \$390 million gap will be bridged with the proceeds of [pension system asset sales](#), \$390 million of which is earmarked for the general fund to help cover pension payments as established in Joint Resolution 188.

The prepared testimony provided a breakdown of the \$25.569 billion consolidated budget for fiscal 2018:

- **General fund net revenue** - \$9.172 billion
- **General fund other assignments** - \$390 million
- **Federal funds** - \$6.371 billion
- **Other incomes** - \$2.037 billion
- **Own incomes** - \$7.059 billion
- **Special state funds** - \$515 million
- **Public improvements fund** - \$0
- **Loans and bond issues** - \$25 million.

While net revenues for the general fund would edge up 2% from the current fiscal year, nearly all of the other categories would decline. The lone exception among them is the “other incomes” category, which would surge nearly 181% to \$2.037 billion from the current year’s \$726 million.

The prepared testimony said the most significant changes in the consolidated budget include a decrease of \$1.173 billion, or 7%, in consolidated operational spending, and a decrease of \$1.403 billion, or 21.8%, in subsidies. These cuts would be offset by converting the pension system into a pay-go “subsidy” of the government of \$2.552 billion.

Senate Treasury Committee Chairwoman Migdalia Padilla said [budget adjustments](#) required by the PROMESA board would be addressed during the legislative process, but she declined to detail them during the hearing, under pressure from minority lawmakers.

Fiscal officials were asked about the board’s [recertification](#) of the fiscal plan that incorporated the revised revenue forecasts, including the elimination of some \$519 million in non-general-fund sales-and-use tax revenue.

“That \$519 million is COFINA money,” AAFAF Director Portela said.

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